90-SBE-001-A

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 85A-448-MW
MEADOWS REALTY COMPANY, ET AL.)

For Appellant: Daniel J. Cooper
Attorney at Law

For Respondent: Paul Petrozzi
Counsel

ORDER DENYING PETITION FOR REHEARING
AND SUBSTITUTING OPINION

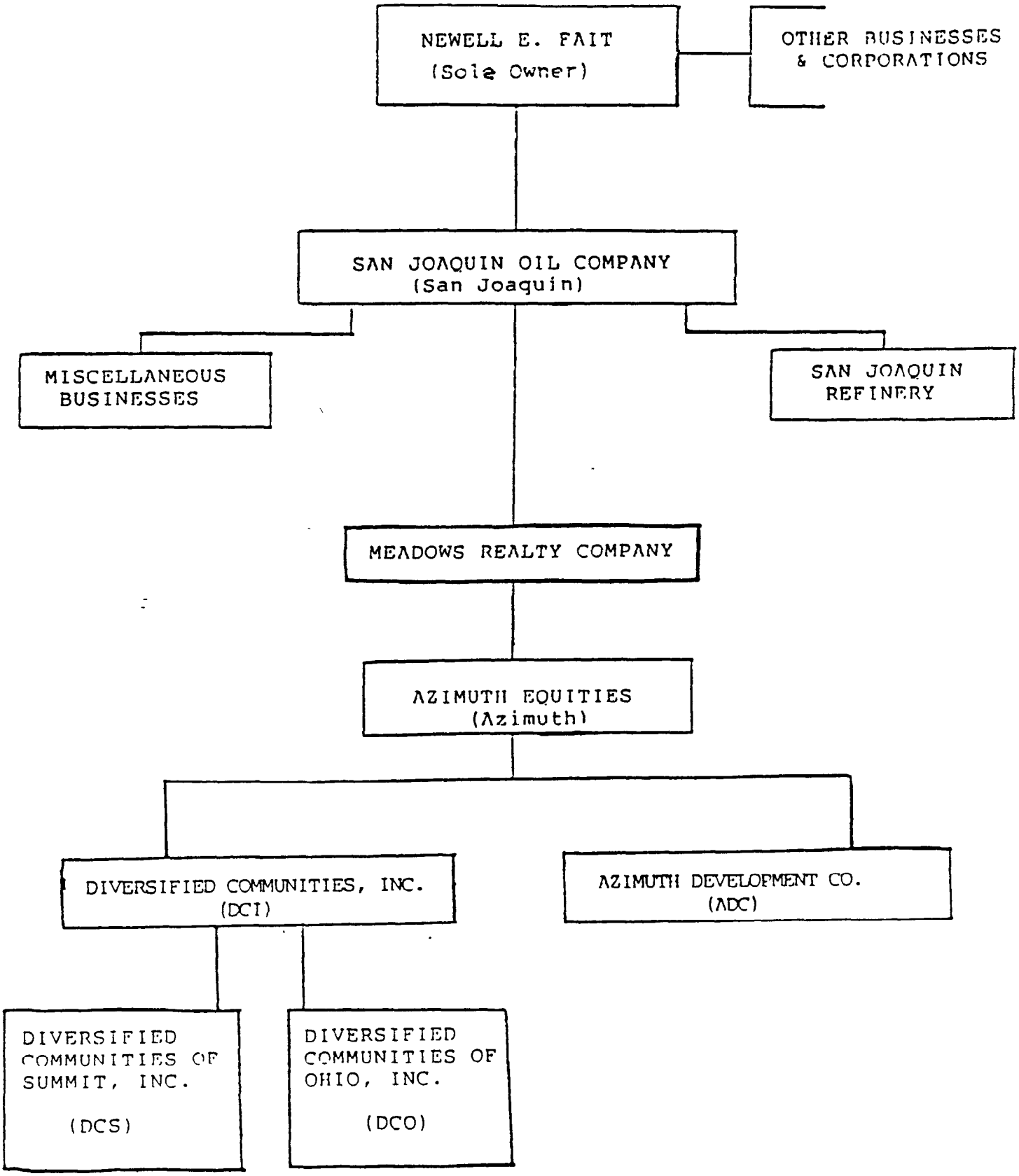
Upon consideration of the timely filed petition of Meadows Realty Co., et al., for rehearing of their appeal from the action of the Franchise Tax Board, we are of the opinion that none of the grounds set forth in the petition or supplemental memorandum constitute cause for the granting thereof and, accordingly, it is hereby ordered that the petition be and the same is hereby denied and that our order of January 24, 1990, be and the same is hereby affirmed.

Good cause appearing therefor, it is also hereby ordered that our opinion of January 24, 1990, in the above entitled matter, except for the first paragraph thereof and the order, be deleted and replaced with the following:

The question presented by this appeal is whether the appellants were engaged in a single unitary business with their parent corporation, San Joaquin Oil Refining Co. (San Joaquin), during the appeal years.[2/]

The appellants were all owned, directly or indirectly, by San Joaquin. San Joaquin, which was solely owned by Mr. Newell Fait (Fait), was principally engaged in oil refining. San Joaquin generated excess funds which were available to expend on other lines of business and, in 1974, it formed Meadows Realty Co. (Meadows) for that purpose. Meadows was a holding company, the sole function of which was to hold the stock and notes of Azimuth Equities, Inc. (Azimuth). Azimuth owned Diversified Communities, Inc. (DCI), and Azimuth Development Co. (ADC). DCI was a holding company which owned two other companies, Diversified Communities of Summit, Inc. (DCS), and Diversified Communities of Ohio, Inc. (DCO). Azimuth developed and managed mobile home parks. ADC, DCS, and DCO developed and sold residential condominiums. A diagram of the corporate structure follows.

[2/] Claraben Mobile Homes, acquired in 1975 and sold in 1977, sold mobile homes. It appears that appellants have conceded that Claraben was not part of any unitary business.


NEWELL E. FAIT
(Sole Owner)
OTHER BUSINESSES & CORPORATIONS
SAN JOAQUIN OIL COMPANY
(San Joaquin)
MISCELLANEOUS BUSINESSES
SAN JOAQUIN REFINERY
MEADOWS REALTY COMPANY
AZIMUTH EQUITIES
(Azimuth)
DIVERSIFIED COMMUNITIES, INC.
(DCI)
AZIMUTH DEVELOPMENT CO.
(ADC)
DIVERSIFIED COMMUNITIES OF SUMMIT, INC.
(DCS)
DIVERSIFIED COMMUNITIES OF OHIO, INC.
(DCO)

At the time San Joaquin acquired them, Azimuth and its subsidiaries were all insolvent and, apparently, had substantial net operating loss carryovers. After the acquisitions, Fait and his management team determined all major policies and arranged all major projects for the corporations in the group. The affiliated group apparently filed combined reports for the appeal years. The Franchise Tax Board (FTB) determined that they were not engaged in a unitary business and disallowed the use of combined reports. The appellants object to the determination that they were not engaged in a unitary business with San Joaquin, but do not argue that they constitute a unitary business themselves, without San Joaquin.

If a taxpayer derives income from sources both within and without California, its franchise tax liability is required to be measured by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If the taxpayer is engaged in a single unitary business with affiliated corporations, the income attributable to California must be determined by applying an apportionment formula to the total income derived from the combined unitary operations of the affiliated companies. (Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).)

The California Supreme Court has held that the existence of a unitary business may be established by the presence of unity of ownership; unity of operation as evidenced by central accounting, purchasing, advertising, and management divisions; and unity of use in a centralized executive force and general system of operation. (Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942).) It has also stated that a business is unitary if the operation of the business done within California is dependent upon or contributes to the operation of the business outside California. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal.2d at 481.) More recently, the United States Supreme Court has emphasized that a unitary business is a functionally integrated enterprise whose parts are characterized by substantial mutual interdependence and a flow of value. (Container Corp. v. Franchise Tax Board, 463 U.S. 159, 178-179 (77 L.Ed.2d 545), rehg. den., 464 U.S. 909 [78 L.Ed.2d 248] (1983)).

The appellants contend that they were unitary with San Joaquin because 1) the ownership requirement was met; 2) they had interlocking officers and directors; 3) only Fait and one other were authorized to sign checks for the subsidiaries; 4) San Joaquin provided financing for the

subsidiaries; 5) they had a common CPA firm; 6) beginning in 1976, all but San Joaquin had common liability insurance; 7) beginning in 1976, they had a common insurance agent; 8) they had a common in-house legal department (Fait's son); 9) they shared common headquarters; 10) some employees performed functions for both San Joaquin and the subsidiaries; and 11) they all submitted monthly reports to Fait and were subject to budget and financial controls. Appellants argue that these factors demonstrate unity between themselves and San Joaquin under both the three unities test and the contribution or dependency test.

The FTB concedes that the ownership requirement is met but argues that the "unitary factors" listed by appellant are not sufficient to support a finding of a unitary business, absent some showing that they result in functional integration of the oil-refining activities with the activities of the subsidiaries. The FTB points out that the factors relied on by appellant are either unsupported by evidence, lacking explanation as to integrating effect, or simply the actions of a prudent investor.

More is required to demonstrate the existence of a unitary business than common ownership and control. (Appeal of Sierra Production Service, Inc., et al., 90-SBE-010, Sept. 12, 1990.) Where, as here, a corporation invests in subsidiaries which are engaged in lines of business truly distinct from its own, the investment "often serves the primary function of diversifying the corporate portfolio and reducing the risks inherent in being tied to one industry's business cycle," rather than making "better use--either through economies of scale or through operational integration or sharing of expertise--of the parent's existing business-related resources." (Container Corp. v. Franchise Tax Board, supra, 463 U.S. at 178; Appeal of Twentieth Century-Fox Film Corporation, 89-SBE-007, Mar. 2, 1989; Appeal of J. B. Torrance, Inc., Cal. St. Bd. of Equal., May 8, 1985.) One must be able to differentiate a unitary business from a group of commonly owned businesses or activities, the operations of which really have no effect upon one another. (Appeal of Sierra Production Service, Inc., et al., supra.)

Although appellants have presented a considerable list of "unitary factors," we find that there has been no showing at all of how these factors caused San Joaquin's oil-refining activities to be integrated with the mobile home park and condominium development activities of the subsidiaries. While it is clear that Fait and his management team did provide

overall management and some staff services for the subsidiaries, there is no evidence that any of this resulted in mutual interdependence or flows of value between San Joaquin's oil-refining operations and those of the subsidiaries or that the "corporations were managed in such a way as to benefit each other's business operations." (Appeal of Sierra Production Service, Inc., et al., supra.) Other potentially integrating factors cited by appellants have not been shown to be substantial in either quantity or quality and, therefore, do not indicate the existence of a unitary business. In short, the attributes relied upon by appellants demonstrate nothing more than Mr. Fait's oversight of his investments, which were unrelated to the operations of San Joaquin. (See, e.g., Appeals of Hollywood Film Enterprises, Inc., Cal. St. Bd. of Equal., Mar. 31, 1982; Appeal of J. B. Torrance, Inc., supra; Appeals of Andreini & Company and Ash Slough Vineyards, Inc., Cal. St. Bd. of Equal., Mar. 4, 1986.)

Appellants also argue that the facts in the Appeal of Wynn Oil Company, decided by this board on February 6, 1980, "dictated a unitary finding and closely parallel the facts present in this appeal . . . ." (App. Memo. of Pts. and Auth. at 9.) They conclude that a finding of unity is, therefore, dictated in this appeal. However, each case must be decided on its own factual record and we have found that this record does not support a finding of unity. In any case, we believe that Wynn Oil is clearly distinguishable from the instant case. In Wynn Oil, Wynn's management completely dominated SRI, the subsidiary in issue. Such overwhelming dominance is not present in this case. Here, Fait's management policy was to hire good managers, provide them with incentive pay, and leave them to operate the subsidiaries in the most profitable manner they could. In essence, Fait's interest and involvement was that of an investor. Therefore, we do not agree with appellants' contention that Wynn Oil "dictates" a finding of unity in the present appeal.

For the reasons discussed above, the action of the Franchise Tax Board in this matter must be sustained.

Done at Sacramento, California, this 6th day of June, 1991, by the State Board of Equalization, with Board Members Mr. Sherman, Mr. Bennett, Mr. Dronenburg, Mr. Fong, and Mr. Davies present.

Brad Sherman, Chairman

William M. Bennett, Member

Ernest J. Dronenburg, Jr., Member

Matthew K. Fong, Member

_____, Member